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HONG KONG FOR REGFINATT

E.O. 11652: N/A

TAGS: ECON, EGEN, EARL, ETRD, KS

SUBJ: KOREA'S ECONOMIC OUTLOOK FOR 1978: EXTERNAL SECTOR

REF: SEOUL 168

BEGIN UNCLASSIFIED - SUMMARY: IN THE EXTERNAL SECTOR, THE KOREAN ECONOMY ACHIEVED ALL MAJOR GOALS IN 1977, INCLUDING THE \$10 BILLION EXPORT BENCHMARK. THE ONLY SIGNIFICANT MISCALCULATION OCCURRED IN THE SERVICES ACCOUNT, WHERE BURGEONING RECEIPTS FROM MIDDLE EAST CONSTRUCTION ACTIVITY GENERATED AN UNEXPECTEDLY RAPID INFLOW OF FOREIGN EXCHANGE. THIS IN TURN CAUSED THE DOMESTIC MONEY SUPPLY TO EXPAND, AGGRAVATING DOMESTIC INFLATIONARY PRESSURES. THE THRUST OF THE ROKG'S EXTERNAL ECONOMIC POLICY DURING THE LATTER HALF OF 1977, AND CONTINUING INTO 1978, HAS BEEN TO CURTAIL FOREIGN EXCHANGE INFLOWS BY (A) ACCELERATING THE MOVEMENT TOWARDS IMPORT LIBERALIZATION, AND (B) CUTTING BACK

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SHORT AND MEDIUM TERM FOREIGN CURRENCY LOANS FROM ABROAD. IN 1978, THE KOREANS SHOULD HAVE LITTLE TROUBLE IN ACHIEVING THEIR EXPORT TARGET OF \$12.5 BILLION, AND BLANANCE OF PAYMENTS EQUILIBRIUM ON CURRENT ACCOUNT. SHORT-TERM CAPITAL INFLOWS WILL BE DRASTICALLY CURTAILED--IN FACT, THERE WILL BE A NET OUTFLOW OF SHORT-TERM CAPITAL--BUT CONTINUED INFLOW

OF LONG-TERM CAPITAL IS EXPECTED TO ADD \$800 MILLION TO KOREA'S ALREADY-SUBSTANTIAL FOREIGN EXCHANGE RESERVES. END UNCLASSIFIED, BEGIN LIMITED OFFICIAL USE - AMONG THE IMPORTANT EXTERNAL ECONOMIC POLICY ISSUES TO BE ADDRESSED IN 1978 ARE: IMPORT LIBERALIZATION; OVERSEAS TRADE PROTECTIONISM; TREATMENT OF FOREIGN BRANCH BANKS IN KOREA; ROKG POLICY TOWARDS FOREIGN INVESTMENT; KOREAN ECONOMIC RELATIONS WITH THIRD COUNTRIES; AND THE QUESTION OF WON/DOLLAR PARITY. END SUMMARY - END LIMITED OFFICIAL USE

1. BEGIN UNCLASSIFIED - REFTEL PROVIDED A GENERAL OVERVIEW OF THE KOREAN ECONOMY'S PERFORMANCE IN 1977, AND PROSPECTS FOR 1978. THIS MESSAGE ADDRESSES ITSELF SPECIFICALLY TO THE EXTERNAL SECTOR, AND ANALYZES SOME OF THE UNDERLYING TRENDS LIKELY TO COME INTO PLAY DURING THE COMING YEAR.

2. THE BROAD LINES OF KORA'S EXTERNAL ECONOMY--WHERE IT'S BEEN AND WHERE IT'S GOING--ARE BEST SUMMARIZED IN THE FOLLOWING TABLE. IT INCORPORATES LATEST ECONOMIC PLANNING BOARD ESTIMATES, WITH WHICH THE EMBASSY IS IN BASIC AGREEMENT.

TABLE 1: SUMMARY BALANCE OF PAYMENTS: 1976-78

(\$ MILLIONS)

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	1976 (ACTUAL)	1977 (ESTIMATED)	1978 1/ (PROJECTED)
TRADE BALANCE	-590	-518	-700
--EXPORTS 2/(FOB)	7,815	10,007	12,500
--IMPORTS (FOB)	8,405	10,526	13,200
NET SERVICES	72	-320	465
--RECEIPTS	1,643	3,055	4,165
--PAYMENTS	1,715	2,735	3,700

1/ IN THESE PROJECTIONS, A 5 PERCENT MARGIN OF ERROR IS GENERALLY REGARDED AS ACCEPTABLE BY THE ROKG.

2/ COMPUTED ON CUSTOMS CLEARANCE BASIS IN 1978, B.O.P. BASIS IN 76-77.

NET TRANSFERS	349	230	235
CURRENT BALANCE	-314	32	0
NET CAPITAL	1,973	1,499	768
--LONG/MEDIUM TERM (OVER 1 YEAR)	1,371	1,388	891
(BASIC BALANCE)	(1,057)	(1,420)	-(891)
--SHORT-TERM	357	59	-666
--BANK ACCOUNTS	245	52	543
ERRORS AND OMISSIONS	-241	-170	0

CHANGES IN FOREIGN

EXCHANGE HOLDINGS 3/ -1,419 -1,361 -768

END-OF-YEAR FX

RESERVES 2,961 4,322 5,090

3/ MINUS SIGN DENOTES INCREASE.

3. EXPORTS: HAVING SUCCESSFULLY ACHIEVED THE \$10 BILLION BENCHMARK IN 1977, THE KOREANS LOOK FORWARD TO ANOTHER YEAR OF STEADY EXPORT GROWTH IN 1978. THE OFFICIAL TARGET OF \$12.5 BILLION--REPRESENTING A NOMINAL GROWTH RATE OF 25 PERCENT--SHOULD BE COMFORTABLY WITHIN REACH; WE WILL NOT BE SURPRISED TO SEE A YEAR-END FIGURE OF 12.7 BILLION. (A RECENT PRIVATE SURVEY OF 116 MAJOR LIMITED OFFICIAL USE

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INDUSTRIAL FIRMS INDICATES THAT THEY EXPECT THEIR OWN 1978 EXPORT SALES TO INCREASE BY AN AVERAGE RATE OF 36 PERCENT). REGARDING ANNUAL EXPORT GROWTH RATES, IT IS INTERESTING TO NOTE THAT KOREA ACHIEVED AN AVERAGE ANNUAL RATE OF 42 PERCENT BETWEEN 1962 AND 1976 (IN CURRENT PRICES); IN 1977, THE GROWTH RATE WAS 28 PERCENT; AND IN 1978 OFFICIAL FORECASTS CALL FOR 25 PERCENT. NOW THAT KOREA IS IN THE "BIG LEAGUES" AS AN EXPORTER, IT MAY BE THAT THE ERA OF 40 PERCENT-PLUS ANNUAL GROWTH RATES IS COMING TO A CLOSE.

4. ACCORDING TO GOVERNMENT PROJECTIONS, THE MANUFACTURING SECTOR WILL PROVIDE THE LION'S SHARE OF KOREAN EXPORTS, WITH A PROJECTED 92 PERCENT OF THE TOTAL IN 1978 (AS COMPARED WITH 90 PERCENT LAST YEAR). THE SECTORAL BREAKDOWN IS AS FOLLOWS:

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TABLE 2: KOREAN EXPORTS, 1977-78
 (\$ MILLIONS)

	1977	PERCENT OF	1978	PERCENT OF
	EST.) TOTAL	(PROJ.)	TOTAL	
LIGHT INDUSTRY	5,400	54	6,720	54
(OF WHICH TEXTILES)	(3,120)	(31)	(3,740)	(30)
HEAVY AND CHEMICAL				
INDUSTRY	3,605	36	4,710	38
AGRICULTURAL PRODS	315	3	370	3
FISHERY ITEMS	571	6	580	4
MINERAL PRODS.	109	1	120	1

LIGHT INDUSTRY IS EXPECTED TO RETAIN ITS DOMINANT POSITION DESPITE THE PROJECTED DECLINE IN THE RELATIVE IMPORTANCE OF TEXTILE EXPORTS (FACED WITH MOUNTING PROTECTIONISM ABROAD, THE KOREANS PRUDENTLY FORECAST A MODEST 20 PERCENT INCREASE IN TEXTILE EXPORTS). THE INCREASING IMPORTANCE OF HEAVY AND CHEMICAL INDUSTRY LIMITED OFFICIAL USE

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IS IN LINE WITH ROKG POLICY, AND REPORTEDLY WILL BE HELPED ALONG BY SPECIAL GOVERNMENT SUPPORT MEASURES SUCH AS LOW-INTEREST CAPITAL LOANS. AGRICULTURE, FISHERY, AND MINERAL EXPORTS WILL REMAIN OF RELATIVELY MINOR IMPORTANCE; FISHERY SALES, IN PARTICULAR, ARE EXPECTED TO LEVEL OFF AS A RESULT OF GROWING PROTECTIONISM AND THE RAPIDLY EXPANDING ESTABLISHMENT OF 200-MILE ECONOMIC ZONES BY THE MAJOR SOURCE COUNTRIES. IN SUMMARY, THE EXPORT TARGET FOR 1978 APPEARS EMINENTLY REASONABLE, MAKING ADEQUATE ALLOWANCE FOR THE EFFECTS OF PROTECTIONISM ABROAD. UNLESS THERE IS A SHARP INCREASE IN OVERSEAS TRADE BARRIERS DURING THE COURSE OF THE YEAR, THE KOREANS SHOULD HAVE NO TROUBLE ACHIEVING THE TARGET.

5. IMPORTS: KOREAN IMPORTS (F.O.B. BASIS) GREW BY 20 PERCENT IN 1977, TO \$10.5 BILLION, AND ARE EXPECTED TO GO

UP BY AN EQUAL PERCENTAGE--TO \$13.2 BILLION--IN 1978. GIVEN THE GOVERNMENT'S STRICT CONTROL OVER IMPORTS, THIS IS A FIGURE THAT CAN BE PREDICTED WITH A FAIRLY HIGH DEGREE OF ACCURACY IN NORMAL TIMES. 1978 IMPORTS COULD BE HIGHER THAN FORECAST, HOWEVER, IF THE GOVERNMENT DECIDES TO ACCELERATE ITS PROJECTED IMPORT LIBERALIZATION PROGRAM AS AN ANTI-INFLATIONARY MEASURE.

6. TRADE BALANCE: PARTLY BECAUSE OF IMPORT LIBERALIZATION MEASURES UNDERTAKEN DURING THE LATTER PART OF THE YEAR, KOREA'S 1977 TRADE DEFICIT, AT \$518 MILLION, WAS SOMEWHAT LARGER THAN THE \$283 MILLION ORIGINALLY ANTICIPATED. A PROJECTED DEFICIT OF \$700 MILLION IN 1978 APPEARS REALISTIC, AND WOULD BE CONSISTENT OF COURSE WITH OUR OWN HUNCH THAT BOTH EXPORTS AND IMPORTS ARE LIKELY TO END UP SLIGHTLY HIGHER THAN ANTICIPATED. LIMITED OFFICIAL USE

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7. TERMS OF TRADE: BASED ON RESULTS THROUGH THE FIRST NINE MONTHS OF THE YEAR, KOREA'S TERMS OF TRADE CONTINUED TO IMPROVE IN 1977 (FOR THE SECOND YEAR IN A ROW). THE EXPORT PRICE INDEX ROSE BY 4.1 PERCENT, WHILE THE IMPORT PRICE INDEX FELL BY 0.3 PERCENT, YIELDING AN IMPROVEMENT OF 4.3 PERCENT IN THE NET BARTER TERMS OF TRADE. THE DISPARITY BETWEEN EXPORT AND IMPORT PRICE MOVEMENTS MAY BE EXPLAINED, IN A NUTSHELL, BY THE FACT THAT KOREAN EXPORTS CONSIST PRINCIPALLY OF MANUFACTURED GOODS, WHICH HAVE BEEN MORE SUSCEPTIBLE, OF LATE, TO PRICE INCREASES THAN THE RAW MATERIALS WHICH DOMINATE KOREA'S IMPORT TRADE. IT IS DIFFICULT TO FORECAST WHAT WILL HAPPEN IN 1978, BUT CERTAIN INDICATIONS--INCLUDING THE PROSPECT OF RELATIVELY STABLE OIL PRICES--POINT IN THE DIRECTION OF A FURTHER IMPROVEMENT IN KOREA'S TERMS OF TRADE.

8. INVISIBLES: IN THE INVISIBLES ACCOUNT, THE BIG STORY CONTINUES TO BE KOREA'S STUNNING SUCCESS IN OBTAINING OVERSEAS CONSTRUCTION CONTRACTS. IN FACT, THE SHEER VOLUME OF SERVICES RECEIPTS IN 1977 WAS QUITE UNANTICIPATED--3.0 BILLION RATHER THAN THE 2.0 BILLION ORIGINALLY FORECAST--AND THE RESULTANT SWELLING OF THE MONEY SUPPLY WAS PERCEIVED AS THE SINGLE MOST IMPORTANT CONTRIBUTOR TO THE PROBLEM OF DOMESTIC PRICE INFLATION. THUS, PARADOXICALLY, THE BRIGHTEST SPOT IN KOREA'S BALANCE OF PAYMENTS PICTURE WAS IN A SENSE THE PLANNERS' GREATEST NEMESIS. THANKS LARGELY TO CONSTRUCTION RECEIPTS, BUT ALSO TO INCREASED EARNINGS FROM OVERSEAS STEVEDORING CONTRACTS AND TOURISM, KOREA MOVED FROM A NET DEFICIT IN THE SERVICES ACCOUNT (IN

1976) TO A SURPLUS OF \$320 MILLION IN 1977. WITH THE
TRANSFERS ACCOUNT, AS USUAL, IN SUBSTANTIAL SURPLUS,
KOREA MANAGED TO ACHIEVE A 1977 CURRENT ACCOUNT SURPLUS
OF \$32 MILLION.
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9. IN 1978, THE SERVICES ACCOUNT SHOULD CONTINUE TO
BOOM. NEW CONSTRUCTION CONTRACTS IN 1977 (90 PERCENT OF
WHICH WERE IN THE MIDDLE EAST) TOTALLED \$3.5 BILLION,
AND SHOULD GO UP TO \$4.0 BILLION IN 1978. THE KOREANS
SHOULD BE ABLE TO RAKE IN \$4 BILLION IN SERVICES
RECEIPTS, AND ACHIEVE AN OVERALL SERVICES ACCOUNT
SURPLUS OF \$465 MILLION AS TARGETTED. ADDING IN NET
TRANSFER OF \$235 MILLION, KOREA SHOULD ACHIEVE \$700
MILLION IN NET INVISIBLE INFLOWS TO OFFSET THE \$700 MILLION
TRADE DEFICIT AND GIVE KOREA AN EQUILIBRIUM ON CURRENT ACCOUNT.

10. LONG/MEDIUM TERM CAPITAL: 1977 WITNESSED A GRADUAL
LEVELLING-OFF OF NET LONG/MEDIUM TERM CAPITAL INFLOWS,
PARTLY AS A RESULT OF DELIBERATE GOVERNMENT POLICY
BUT MAINLY AS A RESULT OF FORCES SET IN MOTION DURING
THE PREVIOUS YEAR. NEW LOANS AND INVESTMENTS INDUCED
IN 1977 (ON AN ARRIVAL BASIS) AMOUNTED TO \$1,900 MIL-
LION, PRECISELY WHAT HAD BEEN ANTICIPATE. THIS AMOUNT

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WAS PARTIALLY OFFSET BY REPAYMENTS OF \$539 MILLION, AND A NET DIFICIT ON THE DEFERRED EXPORT ACCOUNT AS "PROGRESS PAYMENTS" TO KOREAN SHIPBUILDERS DROPPED OFF SHARPLY. MEANWHILE, THE GOVERNMENT CONTRIBUTED TO THE SLOWDOWN OF NEW CAPITAL INFLOWS BY CUTTING DOWN ON NEW BORROWING BY THE KOREAN DEVELOPMENT BANK AND BY PLACING FURTHER RESTRICTIONS ON LONG-TERM TRADE CREDITS FOR KOREAN BORROWERS.

11. ONE OF THE PROMINENT FEATURES OF THE KOREAN BALANCE OF PAYMENTS PICTURE IN 1978 WILL BE A SHARP REDUCTION IN NET LONG/MEDIUM TERM CAPITAL INFLOWS, FROM \$1,388 MILLION (IN 1977) TO \$891 MILLION. THIS REFLECTS A CONSCIOUS EFFORT ON THE PART OF THE GOVERNMENT TO CUT DOWN ON THE FOREIGN EXCHANGE INFLOWS WHICH HAVE AGGRAVATED PROBLEMS OF PRICE INFLATION IN KOREA. BY FURTHER TIGHTENING THE REQUIREMENTS FOR NEW LONG-TERM COMMERCIAL LOANS, THE GOVERNMENT WILL HOLD NEW LIMITED OFFICIAL USE

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LOAN AND INVESTMENT ARRIVALS TO \$1,700 MILLION--ABOUT \$600 MILLION LESS THAN ORIGINALLY FORECAST IN THE FIVE-YEAR PLAN.

12. SHORT-TERM CAPITAL: EVEN MORE DRAMATIC THAN THE CUTBACK ON LOAN-TERM CAPITAL INFLOWS HAVE BEEN THE GOVERNMENT'S ALMOST DRACONIAN MEASURES TO DISCOURAGE THE INFLOW OF SHORT-TERM CAPITAL. INDEED, THIS HAS BEEN THE GOVERNMENT'S MAJOR TOOL IN RESISTING THE BUILDUP OF FOREIGN EXCHANGE RESERVES. AS SHOWN IN TABLE 1, THE NET SHORT-TERM CAPITAL ACCOUNT MOVED FROM A SURPLUS OF \$357 MILLION, IN 1976, TO A SURPLUS OF ONLY \$52 MILLION IN 1977, AND IS PROJECTED TO MOVE INTO A DIFFICIT OF \$666 MILLION IN 1978. THE MEANS OF ACHIEVING THIS STUNNING REVERSAL ARE QUITE STRAIGHT-FORWARD: FOREIGN-SOURCED TRADE CREDITS FOR IMPORTED ITEMS WILL BE VIRTUALLY ELIMINATED, WHILE RESTRICTIONS ON ADVANCE PAYMENT FOR KOREAN EXPORTS (RED-CLAUSE L/C'S) WILL BE SUCH AS TO STRONGLY DISCOURAGE THIS FORM OF FINANCING. ALL CATEGORIES OF SHORT-TERM FINANCING WILL SHOW NET OUTFLOWS FROM KOREA--RATHER THAN INFLOWS WHICH HAVE CONSTITUTED THE NORMAL PATTERN.

13. BANK ACCOUNTS: BANK-TO-BANK TRANSACTIONS, WHICH

INCLUDE BOTH LONG-TERM AND SHORT-TERM CAPITAL FLOWS, DISPLAY A RATHER IRREGULAR PATTERN. IN 1977, NET CAPITAL INFLOWS VIA THIS CHANNEL WERE CUT BACK QUITE EFFECTIVELY, THUS SUPPORTING THE BROAD GOVERNMENT POLICY OF REDUCING KOREA'S ACCUMULATION OF FOREIGN EXCHANGE. THIS WAS ACCOMPLISHED, APPARENTLY, BY: (A) INDUCING KOREAN BANKS TO SHIFT A LARGE PORTION OF THEIR FOREIGN EXCHANGE RESERVES TO OVERSEAS BRANCHES; AND (B) LIKEWISE INDUCING KOREAN COMPANIES--CONSTRUCTION FIRMS, FOR THE LIMITED OFFICIAL USE

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MOST PART--TO HOLD THEIR FOREIGN EXCHANGE BANK DEPOSITS OVERSEAS RATHER THAN IN KOREA. THE MAJOR (BANK-TO-BANK) FACTOR BRINGING FOREIGN CAPITAL BACK INTO THE COUNTRY DURING 1977 WAS THE ACTIVITY OF FOREIGN BRANCH BANKS IN KOREA, WHICH ACCOUNTED FOR NET FOREIGN EXCHANGE INFLOWS OF \$426 MILLION. IN 1978, THE GOVERNMENT APPARENTLY INTENDS TO ALLOW KOREAN BANKS TO REPATRIATE THEIR FOREIGN EXCHANGE RESERVES. THIS UNDESIRABLE MOVEMENT OF CAPITAL WILL BE OFFSET, TO SOME EXTENT, BY A FORCED REDUCTION OF FOREIGN BRANCH BANK LENDING IN KOREA; THE NET EFFECT, HOWEVER, WILL BE A SUBSTANTIAL INFLOW OF FOREIGN EXCHANGE--\$543 MILLION--VIA THE BANK-TO-BANK CHANNEL. PRESUMABLY, IN A PINCH, THE GOVERNMENT COULD AGAIN CUT BACK ON FOREIGN EXCHANGE RESERVES BY HAVING KOREAN BANKS TRANSFER FUNDS OVERSEAS.

14. DEBT POSITION: ACCORDING TO LATEST EPB ESTIMATES, WHICH CONFORM CLOSELY WITH EMBASSY CALCULATIONS, KOREA'S EXTERNAL DEBT POSITION SHAPES UP AS FOLLOWS:

TABLE 3: DEBT OUTSTANDING (ARRIVAL BASIS,
END OF YEAR, \$ MILLIONS)

	1976	1977	1978
	(ACTUAL)	(PREL.)	(PROJ.)

LONG-TERM CAPITAL	7,081	8,511	9,468
(OVER 3 YEARS)			

MEDIUM-TERM TRADE	285	231	200
CREDITS (1-3 YEARS)			

SHORT-TERM CAPITAL	2,662	3,430	3,230
(UNDER 1 YEAR)			

TOTAL	10,028	12,172	12,898
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THESE FIGURES CLEARLY REFLECT THE GOVERNMENT'S EFFORTS TO CUT BACK ON CAPITAL INFLOWS. WHILE TOTAL DEBT OUTSTANDING WILL CONTINUE TO GROW IN 1978, REDUCTIONS ARE PLANNED FOR SHORT-TERM AND MEDIUM-TERM DEBT, REGARDED BY THE GOVERNMENT AS LESS SUPPORTIVE OF KOREAN NATIONAL INTEREST. LONG-TERM DEBT WILL CONTINUE GROWING, BUT AT A SLOWER PACE; AND IN THIS REGARD A GREATER EMPHASIS WILL BE PLACED ON CONCESSIONARY PUBLIC LOANS, WHILE LESS FAVORABLE COMMERCIAL LOANS ARE SUBJECT TO INCREASING RESTRICTIONS.

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15. FOREIGN EXCHANGE RESERVES: WITHOUT A DOUBT THE MAIN WORRY OF KOREA'S ECONOMIC PLANNERS DURING THE LATTER HALF OF 1977 WAS DOMESTIC PRICE INFLATION, BROUGHT ABOUT BY AN UNEXPECTEDLY RAPID GROWTH OF THE MONEY SUPPLY. THE PRINCIPAL CULPRIT BEHIND EXPANSION OF THE MONEY SUPPLY WAS PERCEIVED TO BE THE EXCESSIVE BUILDUP OF FOREIGN EXCHANGE RESERVES, AND THE THRUST OF THE GOVERNMENT'S ECONOMIC POLICY DURING THIS PERIOD WAS TO COUNTER THAT TREND IN TWO WAYS: (A) BY LIBER-

ALIZING IMPORTS; AND (B) BY REDUCING SHORT-TERM AND MEDIUM-TERM CAPITAL INFLOWS. AS DISCUSSED IN THE PRECEDING PARAGRAPHS, THESE MEASURES WILL BE FURTHER INTENSIFIED IN 1978, AND REINFORCED BY PLACING FURTHER RESTRICTIONS ON LONG-TERM COMMERCIAL LOANS AS WELL. THE RESULT, THE GOVERNMENT HOPES, WILL BE TO HOLD END-OF-YEAR FOREIGN EXCHANGE RESERVES TO \$5,090 MILLION IN 1978, ROUGHLY AN \$800 MILLION INCREASE OVER THE \$4.3 BILLION FIGURE FOR 1977. - END UNCLASSIFIED.
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16. BEGIN LIMITED OFFICIAL USE - POLICY ISSUES AND IMPLICATIONS: KOREA'S EXTERNAL POLICY ISSUES, MOST OF WHICH WILL AFFECT U.S. INTERESTS IN ONE WAY OR ANOTHER.

(A) IMPORT LIBERALIZATION: THE LOGIC OF ECONOMICS IS NUDGING KOREA IN THE DIRECTION OF INCREASINGLY BOLD IMPORT LIBERALIZATION MEASURES. WE SHOULD DO EVERYTHING IN OUR POWER TO ENCOURAGE THE MOMENTUM NOW ESTABLISHED BY KEEPING THIS TOPIC IN THE FOREFRONT OF DAY-TO-DAY REPRESENTATIONS. IN 1977, U.S. EXPORTS TO KOREA TOTALLED APPROXIMATELY \$2.4 BILLION. WITH SUBSTANTIAL LIBERALIZATION OF KOREAN IMPORT BARRIERS, THAT FIGURE COULD CONCEIVABLY BE INCREASED BY SEVERAL HUNDRED MILLION DOLLARS ANNUALLY.

(B) TRADE BARRIERS AGAINST KOREAN EXPORTS: ACCORDING TO EMBASSY ESTIMATES, MOUNTING TRADE BARRIERS OVERSEAS--INCLUDING THOSE IMPOSED BY THE UNITED STATES--PROBABLY COST THE KOREANS SOMETHING ON THE ORDER OF \$500 MILLION IN EXPORTS IN 1977. ASIDE FROM DAMAGING THE INTERESTS OF CONSUMERS IN THE IMPORTING COUNTRIES, SUCH PROTECTIONIST TENDENCIES CONSTITUTE THE MOST TELLING SINGLE ARGUMENT AGAINST IMPORT LIBERALIZATION IN KOREA. FROM THIS PERSPECTIVE ANY NEW BARRIERS ERECTED AGAINST KOREAN EXPORTS TO THE US WOULD WORK AGAINST OUR EFFORTS TO EXPAND EXPORTS HERE JUST AT A TIME WHICH APPEARS TO BE MOST OPPORTUNE TO DO SO.

(C) TREATMENT OF FOREIGN BRANCH BANKS IN KOREA: KOREAN GOVERNMENT MEASURES TO CURTAIL THE INFLOW OF FOREIGN CAPITAL HAVE ADVERSELY AFFECTED THE OPERATIONS OF FOREIGN BRANCH BANKS IN KOREA. SO-CALLED SWAP
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TRANSACTIONS, WHEREBY BRANCH BANKS ARE PERMITTED TO SWAP FOREIGN EXCHANGE FOR WON CURRENCY WHICH MAY IN TURN BE LENT LOCALLY AT HIGH INTEREST RATES, HAVE BEEN CUT TO THE BONE--STRIKING DIRECTLY AT THE BRANCH BANKS' MOST LUCRATIVE SOURCE OF PROFITS. AT THE SAME TIME, THE PERMITTED VOLUME OF SHORT-TERM FOREIGN CURRENCY LOANS FROM ABROAD HAS BEEN SUBSTANTIALLY REDUCED AND TIGHTER CONDITIONS HAVE BEEN PLACED ON LONG-TERM PROJECT LOANS. AS OF JANUARY 1978, THERE ARE 24 FOREIGN BRANCH BANKS IN KOREA, OF WHICH 8 ARE AMERICAN. INDICATIONS ARE THAT AS MANY AS AN ADDITIONAL 10 MAY BE APPROVED THIS YEAR, RESULTING IN AN EVEN SMALLER SHARE OF AN EVER-DWINDLING PIE FOR EACH BANK. WE SHOULD CONTINUE LOW-KEY REPRESENTATIONS TO THE ROKG IN FAVOR OF IMPROVING TREATMENT FOR THE FOREIGN BRANCH BANKS DURING THIS TRANSITION PERIOD, URGING IMPORT LIBERALIZATION AS THE PREFERABLE SOLUTION TO THE PROBLEM OF EXCESS FOREIGN EXCHANGE.

(D) ROKG POLICY TOWARDS FOREIGN INVESTMENT: THE KOREANS HAVE NOT PROMOTED FOREIGN INVESTMENT AS A TOP PRIORITY GOAL IN ITS EXTERNAL ECONOMIC POLICY. THE PRESENT SYSTEM OF INCENTIVES FOR FOREIGN INVESTMENT IS A GENEROUS ONE, BUT INDICATIONS ARE THAT ADVANTAGES ENJOYED BY FOREIGN (OVER DOMESTIC) INVESTORS MAY BE SHARPLY REDUCED IN THE NEXT YEAR OR TWO. WE WILL CONTINUE TO MONITOR THESE DEVELOPMENTS CLOSELY WITH A VIEW TO INTERCEDING ON BEHALF OF US FIRMS IF CIRCUMSTANCES WARRANT.

(E) KOREAN RELATIONS WITH THIRD COUNTRIES: PARTLY AS A MEANS OF FOSTERING NEW EXPORT OUTLETS, PARTLY AS A MEANS OF DIVERSIFYING IMPORT SOURCES (AND PARTLY FOR POLITICAL REASONS), THE KOREANS HAVE BEEN AGGRESSIVE IN DEVELOPING ECONOMIC TIES WITH THE MIDDLE EAST, EUROPE, AND HITHERTO UNTAPPED THIRD WORLD MARKETS. LIMITED OFFICIAL USE

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WE SHOULD ENCOURAGE THIS TREND, BUT KEEP ALERT FOR POSSIBLE ADVERSE EFFECTS ON US ECONOMIC INTERESTS. IN FACT, THE US MAY BE ABLE TO TAKE ADVANTAGE OF SOME OF THE OPPORTUNITIES PRESENTED. US ENGINEERING FIRMS MIGHT GIVE SERIOUS CONSIDERATION TO TEAMING UP WITH KOREAN CONSTRUCTION FIRMS ON OVERSEAS PROJECTS OF AN ADVANCED TECHNOLOGICAL NATURE IN MANY PARTS OF THE WORLD.

(F) WON/DOLLAR PARITY: AN ADJUSTMENT OF THE WON/DOLLAR PARITY DOES NOT APPEAR TO BE A PROSPECT FOR 1978. ORDINARILY, INFLATIONARY TRENDS IN KOREA, BY CUTTING INTO EXPORTERS' PROFIT MARGINS, GENERATE

PRESSURES FOR DEVALUATON. THIS YEAR, HOWEVER, THE
PROBLEM OF EXCESS FOREIGN EXCHANGE INFLOWS CREATES A
COUNTERARGUMENT IN FAVOR OF REVALUATION. THE LIKELY
RESULT OF THESE CONFLICTING PRESSURES WILL BE A DECI-
SION TO TAKE NO ACTION AT ALL FOR THE TIME BEING.
END LIMITED OFFICIAL USE.
SNEIDER

LIMITED OFFICIAL USE

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 18 jan 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978SEOUL00423
Document Source: CORE
Document Unique ID: 00
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Film Number: D780028-0242
Format: TEL
From: SEOUL
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780149/aaaabpkv.tel
Line Count: 609
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 0cfd3be2-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 12
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Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 78 SEOUL 168
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
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SAS ID: 3753608
Secure: OPEN
Status: NATIVE
Subject: KOREA'S ECONOMIC OUTLOOK FOR 1978: EXTERNAL SECTOR
TAGS: ECON, EGEN, ETRD, KS
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/0cfd3be2-c288-dd11-92da-001cc4696bcc
Review Markings:
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